Executive Registry
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OFFICE OF MANAGEMENT AND BUDGET
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January 29, 1985

MEMORANDUM FOR JOHN MCMAHON

FROM: JOE WRIGHT

SUBJECT: CIA Retirement Plan

John -- this memo follows up on our conversation concerning the status of retirement changes in the CIA.

The CIA had been informed in the passback that the reform proposal included in the Budget for the Civil Service Retirement System, which covers the general Federal workforce, would also be proposed for the CIA's special retirement plan.

However -- the major proposed change -- the penalty for retirement before age 65 -- has been modified to reflect the fact that CIA now has an earlier retirement age, age 50 instead of age 55, when full benefits are payable. The change for CIA would introduce a reduction in the retirement benefit of 5 percent for each year the employee is under age 60 at retirement. The reduction would be phased in for employees over 40, with no effect on those already age 50. The full penalty would reduce benefits at at age 50 by one half of what is payable under the current system.

The penalty for pre-60 retirement is also proposed for the Foreign Service Retirement System.

The rest of the changes proposed for Civil Service Retirement would also apply to CIA retirement:

- No cost-of-living adjustment would be given in 1986.
- Subsequent COLA's would be the lesser of the CPI or General Schedule pay increase. Fifty-five percent of the COLA would be given to that portion of an annual benefit over $10,000. The $10,000 would be increased by each COLA.
- The salary base for calculating the benefit would change from the high-three to high-five average salary, credit for unused sick leave would be phased out.
- Student benefits and the minimum annuity would be eliminated for the future and benefits for the surviving spouses of deceased workers would be payable when there are minor children and when the spouse is over age 60 -- these changes parallel Social Security provisions.

Thanks for your call -- I hope this adjustment takes care of the problem.

File Retirement

Battles Loom Over Old, New Retirement Plans:

Administration Budget-Cutters See Big Savings in Reducing Civil Service Pension Benefits

Armed with conflicting sets of studies and agendas, federal-worker unions and the Reagan administration are squaring off this year over the government's pension system.

The fight has high stakes, because, after Social Security and Medicare, the civil service retirement system is the largest entitlement program in the federal government, costing taxpayers about $20 billion a year.

That total is about half of all pension costs paid by the federal government. The government also has retirement systems for the military, costing about $14 billion a year; foreign service workers, costing $200 million a year; and railroad employees, costing $5 billion a year.

The administration, looking for ways to cut the budget, has sought cuts in civil service retirement benefits, arguing that the system costs more than private-sector plans. Unions, on the other hand, argue that benefits are barely adequate.

Different ways of measuring costs and benefits in public- and private-sector pension plans have clouded the issue and made comparisons of them difficult.

The debate will be sparked anew when President Reagan submits his budget to Congress Feb. 4. The president's budget is expected to recommend proposed reductions in retirement benefits similar to those Congress has rejected in the past. *(1984 Weekly Report p. 537)*

Soon after the budget is presented, the administration will submit a proposal for a new, separate retirement program for workers hired after Jan. 1, 1984. They, unlike their more senior colleagues in the civil service, pay into the Social Security system, under a change in the law enacted in 1983 to help shore up Social Security. Congress and the administration are under a statutorily imposed deadline of January 1986 to design a retirement plan for those workers. *(1983 Almanac p. 573)*

—*By Robert Rothman*

Sen. Ted Stevens, R-Alaska, chairman of the Senate Governmental Affairs Subcommittee on Civil Service, has drafted a plan for new workers that he says will cost less in the long run than the existing retirement plan, and give some workers better benefits than they would get under the existing plan. Both changes are also goals of the administration, although they differ over specifics.

House members plan hearings to examine the entire range of pay and benefits for federal workers. Members of the Democratic-controlled chamber are likely to resist any cuts, and say they would only support a new system comparable to the present system.

Current Retirement System

The federal retirement system, established in 1920, is one of the chief benefits offered to federal workers, including employees of the Postal Service and the legislative branch.

Currently, 2.7 million workers contribute, through payroll deductions, 7 percent of their salaries into the civil service retirement fund. That amount is matched by taxpayer contributions paid through federal agencies' budgets. The Treasury will pay an additional $4.37 billion into the fund as its fiscal 1985 contribution from general revenues to cover unfunded future liabilities caused by an anticipated gap between contributions received and benefits owed.

Benefits for the 1.9 million annuitants average about $14,000 a year, according to the Office of Personnel Management (OPM). Most workers are entitled to full pensions if they retire at age 55 with 30 years' service; at age 60 with 20 years' service, and age 62 with five years' service. Certain employees, including air traffic controllers and members of Congress, can retire earlier with more liberal benefits.

Annuities — annual benefit payments — are based on the highest three consecutive years of earnings, and are adjusted annually for inflation. Benefits are fully taxable.

Retirement Criticism

In recent years, critics have called the system overly generous compared with private-sector plans, and have recommended cutting benefits to match those of private employees.

But union officials and their supporters in Congress have argued that private employees actually receive greater retirement benefits than federal workers.

In part, the dispute over the relative value of pension systems has come about because of different ways of measuring benefits.

Rep. William E. Dannemeyer, R-

"I take this study as a clear and convincing argument that there is no justification for any reductions in the total value of pay and benefits for federal workers."

—Rep. William D. Ford, D-Mich., chairman, House Post Office and Civil Service Committee

Many agree with him. But Frank said, "I think that [July 1, 1983] will be the cutoff date."

And, Proxmire said forcefully, "You are looking at one senator who takes that date very, very seriously."

Interstate Banking

Another leftover from last year's banking debate involves whether Congress should sanction compacts that some states have formed to permit interstate banking within their regions.

States in New England, the Southeast, West, Southwest and Midwest have formed or are considering pacts that would permit banks within their regions to merge or to open branches across state lines. The purpose is to allow local banks to expand, free of competition from large New York and California banks.

Garn's 1984 bill would have given Congress' blessing to such compacts for five years. There was no action on a House bill.

Since then, the U.S. Supreme Court has agreed to consider a case filed by New York-based Citicorp and Northeast Bancorp of Connecticut against the New England compact. The banks contend that the pacts are unconstitutional since they infringe on interstate commerce.

The states argue that the 1956 Bank Holding Company Act allows states to approve interstate banking on a reciprocal basis with other states. A federal appeals court agreed with the states. A ruling from the Supreme Court is not expected before June.

Barnard, who for the second year has filed a bill (HR 52) in the House to approve the compacts, said, "They are well within the meaning of federal law as Congress intended."

But New Yorker LaFalce condemns the pacts as leading to "the financial Balkanization of America. It makes no sense."

Some members do not favor interstate banking, even within regions. "One of the great, great advantages of the American banking system is we have locally owned banks," Proxmire said. "Any step in the direction of crossing state lines threatens that."

Consumer Issues

As Congress has debated whether to deregulate banks' powers to deal in other services, earlier laws that deregulated interest rates have spawned adverse side effects for lower-income customers.

In 1980, Congress eliminated the ceilings on interest rates that banks could pay on deposits. Though savers and investors now earn more, many also are paying more for basic services. *(1980 Almanac p. 276; 1982 Almanac p. 45)*

Banks say the changes, such as higher charges for cashing checks or new fees to write checks, are necessary to offset their expense of paying higher interest.

But the moves also are part of a strategy known within the industry as "demarketing" — discouraging less affluent customers and courting those with money to invest.

St Germain said that when Congress considers a comprehensive banking bill, it "would be foolish, indeed, if it did not, up front, demand some quid pro quos for the American consumer. . . ."

In 1985, an unusual number of consumer advocates will be pressing those demands before banking committees. Five groups have assigned representatives to deal solely with banking: Consumers Union, Consumer Federation of America, Ralph Nader's Congress Watch and Public Interest Research Groups and the Center for Community Change.

> ***"I sense an overwhelming concern about these non-bank banks and a desire to end this backdoor silliness forthwith."***
>
> **—Rep. Fernand J. St Germain, D-R.I.**

St Germain's staff has met with the advocates, and the chairman's consumer agenda — as detailed in his Jan. 3 floor statement — included many elements of theirs.

He said the committee will consider banks' fees, branch closings in poor neighborhoods and "float," or the practice of holding of customers' checks for up to several weeks until they clear.

Also, St Germain said he will support efforts to enact a federal truth-in-savings law to avoid confusion over customers' interest earnings, and to bolster the 1975 Home Mortgage Disclosure Act and 1977 Community Reinvestment Act, both of which are intended to guard against discrimination in lending to individuals and neighborhoods.

Deposit Insurance Reform

For years, experts have called for reform of the deposit insurance system, which was created in the Depression to restore savers' confidence in banks. Critics say the system has changed from one meant to protect small depositors to one that insures all losses, even at large multinational banks. *(Background, 1984 Weekly Report p. 2244)*

Currently, all accounts are insured by law up to $100,000. But in effect, all sums have been protected since regulators generally have merged failed institutions with healthy ones, at no loss to depositors.

Last year, William Isaac, chairman of the Federal Deposit Insurance Corp., tried to go back to the limit, so that large depositors would be careful about where they bank and thus exert discipline on badly run firms. But when Continental nearly failed, to avert a run by multimillion-dollar depositors, the government announced it would insure all of Continental's accounts.

Members of Congress complained that a two-tier banking system was born: the smaller banks in their districts that were left to fail in record numbers, and the major U.S. banks dubbed "TBTF," or Too Big to Fail.

The Continental problems added strength to the long-simmering proposals for deposit insurance reform, but Congress — running out of time — put off any action until 1985.

Proponents of reform, however, worry that members already have forgotten the crises of last year and that reform will be lost in another battle over banking deregulation.

But others say continued failures of banks in the Farm Belt will revive the memories of Continental's rescue, stoking sentiment for change.

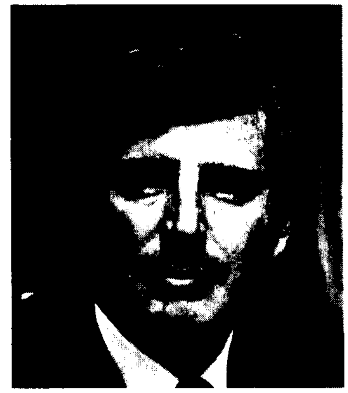
Banks and S&Ls pay insurance premiums to support their respective deposit-insurance funds, and one popular proposal would impose higher fees on banks that are judged to be bigger risks.

That provision is likely to be included in an administration reform package.

Former Treasury Secretary Donald T. Regan has said other proposals might include charging premiums on banks' foreign deposits, which currently are exempt; requiring greater disclosure of problem loans; and raising the amount of capital that banks must have on hand to guard against losses. ▮

"The vast majority of federal employees don't do very well. That's not a good retirement system."

—Donald J. Devine, director, Office of Personnel Management



"Employees have a contract with the federal government, and a change in the retirement system is not part of that contract."

—Jane McMichael, legislative director, American Federation of Government Employees

Calif., ranking Republican on the House Post Office Compensation and Employee Benefits Subcommittee, acknowledges that private pensions are more generous than civil service benefits, if annuities at the time of retirement are compared.

But, he said, the proper basis of comparison is the so-called "normal cost": the percentage of payroll that would have to be set aside from every paycheck over a career to pay for lifetime pension benefits.

According to a study released Jan. 16 by the Congressional Research Service, the normal cost of the civil service retirement system is 24.7 percent of payroll, while private-sector plans range between 14.8 percent of payroll and 19 percent of payroll. The civil service system costs more, the report explains, because it allows workers to retire with full benefits earlier than in most private plans, and because benefits are indexed for inflation.

However, the CRS report also noted that private employers enjoy a tax subsidy, because earnings on pension trust funds are tax-exempt and contributions to the funds are deductible in the year in which they are made. Those tax advantages, the report explains, significantly reduce the costs of private plans.

The sharpest attack on the current federal system has come from the President's Private Sector Survey on Cost Control, better known as the Grace commission after its chairman, industrialist J. Peter Grace.

The Grace commission report said that if Congress had set up military and civil service retirement plans equal to a typical plan in a *Fortune* 500 company, over the last 10 years it "would have cost taxpayers $103 billion less than it actually did. Over the next 10 years taxpayers would have saved $314 billion."

To lower costs, the Grace commission recommended raising the retirement age and scaling back cost-of-living adjustments (COLAs). The Reagan administration has endorsed those changes in the past, and is expected to recommend them again in this year's budget.

Other critics have proposed additional changes in the current system. Former Rep. Hastings Keith, R-Mass. (1959-73), co-chairman of the National Committee on Public Employee Pension Systems, has suggested granting full COLAs only to those retirees whose annuity level is below a certain amount; those who receive higher annuities would receive reduced COLAs. The administration is expected to adopt this idea and propose a limit of $10,000 in annual benefits to qualify for full COLAs.

A private study requested by OPM outlined another possible problem with the current system. According to the study, prepared by the Washington consulting firm of Towers, Perrin, Forster and Crosby, the system favors workers who stay in government for a long time. "The vast majority of federal employees don't do very well," said Donald J. Devine, director of OPM. "That's not a good retirement system."

Devine said he would prefer a retirement system — perhaps including a tax-exempt savings program — that would not penalize workers for leaving the government before they are eligible for full retirement benefits. Such a system, he said, would be good for managers as well.

Union Reaction

Unions have fought pension reductions, arguing that cuts would break faith with employees, who have worked in expectation of receiving certain benefits at a certain time.

"Employees have a contract with the federal government," said Jane McMichael, legislative director of the American Federation of Government Employees (AFGE), "and a change in the retirement system is not part of that contract."

L. J. Andolsek, president of the National Association of Retired Federal Employees, accused the administration of treating the retirement system as a welfare system. On the contrary, Andolsek said, "We're not asking for anything that doesn't belong to us."

Other supporters of employees have refuted the specific charges made by critics of the system. A pamphlet entitled "Ten Myths About Civil Service Retirement," published by the Federal Government Service Task Force, a congressional group chaired by Rep. Michael D. Barnes, D-Md., outlines objections to the critics.

The task force report noted, for example, that most private-sector employees — including those of W. R. Grace & Co. — receive greater retirement benefits than federal workers. Beyond pensions, most private employees are covered under Social Security and qualify for other benefits, such as tax-exempt savings plans, the report noted. And, most private-sector plans are fully paid by employers, while federal workers pay 7 percent of their salaries toward retirement.

Moreover, while federal retirees may retire at 55, most retire later, the task force noted. In fact, as the report stated, the average retirement age of federal retirees (60.7) is similar to the average retirement age of private-sector employees (61.8).

These findings were corroborated by a July 1984 study by the General Accounting Office.

Total Federal Compensation

To union officials like David Gusky, legislative director of the National Federation of Federal Employees, comparing retirement systems tells only part of the story.

"The retirement system, particularly when you look at other aspects of compensation, is nothing more than adequate right now," said Gusky.

Rep. Mary Rose Oakar, D-Ohio, chairman of the House Post Office and Civil Service Subcommittee on Compensation and Employee Benefits, has said that in February she will hold hearings to evaluate all compensation for federal workers — salaries, pensions and other benefits.

The hearings will likely focus on a Dec. 4 study performed for the Post Office committee by the Hay Group, an international consulting firm specializing in human resources, which looked at overall compensation. The Hay study found that federal retirement benefits exceed private pensions, but total pay and benefits for federal workers fall behind those of private-sector employees.

As a result, some members of Congress, citing the study, have served notice that they will resist any attempt to cut benefits for civil servants. "I take this study as a clear and convincing argument that there is no justification for any reductions in the total value of pay and benefits for federal workers," said Rep. William D. Ford, D-Mich., committee chairman.

New System

The cost of the current system and relative value of benefits will also be the key issues in the debate over what sort of pension system to set up for those new federal workers covered by Social Security.

At this point, the only comprehensive plan on the table is the one offered by Stevens, who had authored the proposal providing for interim pension coverage for workers paying into the Social Security system.

Stevens' plan, not yet introduced as legislation and subject to change, has been compared to a three-legged stool, like many private-sector plans. One leg is Social Security, one is the basic retirement plan, and the third is a so-called "thrift" plan, which allows workers to contribute a part of their income, matched by employer contributions, free of income taxes until the savings are withdrawn.

The so-called "401(k)" savings plan, named for its designation in the tax code, would — under Stevens' proposal — give workers the option of saving up to 16 percent of their pay. The government would contribute $2 for every $1 contributed by an employee, up to 8 percent of the employee's salary.

If Congress had set up retirement plans equal to one at a typical* Fortune *500 company, over the last 10 years it "would have cost taxpayers $103 billion less. . . . Over the next 10 years taxpayers would have saved $314 billion."

—Grace commission report

Sen. Paul S. Trible Jr., R-Va., has introduced a bill (S 202) allowing federal workers to contribute up to 5 percent of their salaries into a tax-sheltered account, matched by an equal contribution from the government.

Stevens' plan also would reduce some benefits available under the basic retirement plan. It would allow employees with 30 years' service to retire at 55, as under current law, but it would reduce annuity payments by 2 percent for each year of retirement before age 62. To allow workers covered by the current system to take advantage of the thrift plan, Stevens would also allow workers to switch to the new system.

Savings Disputed

Stevens has touted his plan as cheaper than the current system, noting that it would reduce costs by 15 percent by the time workers begin to draw on it, in about 25 years.

OPM Director Devine said that while the "long-term cost of the proposal is lower, the transition costs of [Stevens' plan] are extremely high." Devine added that for the next five to 35 years, because of government contributions to the thrift plan and reduced employee contributions, "the Stevens method would cost substantially more than the present system."

The future cost reductions, moreover, would not be spread across the board. The thrift plan means that workers who leave before becoming eligible for full benefits would be better off under Stevens' plan than under the current system. But, because of Stevens' proposed penalty for early retirement, those over 55 who leave after 30 years of service would be worse off than they are now.

Stevens is continuing to seek comments from employee unions. The initial reaction has been guarded, but there has been criticism about specific provisions.

Some unions have criticized the thrift plan, arguing that it favors upper-income workers, who can better afford to set aside part of their income than employees in lower grades.

Critics have also noted that the tax-deferred feature of the proposal would require the package to be referred as well to the House Ways and Means and Senate Finance committees, which could add extra delays to the plan's consideration.

Stevens' proposal to allow participants in the current system to join the new one has also drawn fire. The AFGE's McMichael said that provision could jeopardize the current system by reducing contributions to it.

Devine says that the current system has worn down morale, by encouraging workers to stay 30 years. "I'm not sure that's a good thing," he said. "People feel trapped. They feel resentful."

But Loretta Ucelli, a spokeswoman for AFGE, said, "Perhaps Dr. Devine is making a mockery out of the morale problem that currently exists among federal workers. There are so many other factors."

In place of the current system, Devine would establish a system of benefits that are "portable"; that is, they can be taken from job to job without any loss of credit.

As a result, Devine said that he is looking at a retirement plan that encompasses only Social Security plus some form of employee savings, but includes no classic employer-provided pension.

"You should be able to collect on retirement regardless of whether you're with the government or not,' Devine said.

 Post 11/21/84 Retirement

Civil Servants Face Possible Revamping Of Retirement Plan

First-Year Savings of $1.9 Billion Projected

By Spencer Rich
Washington Post Staff Writer

President Reagan's forthcoming budget is expected to propose a major restructuring of the Civil Service retirement system that would limit cost-of-living increases in benefits, reduce benefits of those who in the future retire before age 65 and increase the employe's pension contribution from 7 percent to 9 percent of pay.

The changes are designed to save the government about $1.9 billion in the first year alone.

The Civil Service plan is part of series of proposals under consideration to reduce federal spending and cut the anticipated $206 billion federal deficit for fiscal 1986. Others involve reductions in farm subsidies, restrictions on veterans' health benefits, cuts in federal grants to the states and localities, and curbs on Medicare and Medicaid.

In California yesterday a senior White House official said President Reagan also may revive the idea of abolishing the Education Department. [Details, Page A6].

The Civil Service retirement changes would affect about 1.9 million retirees and dependents, including at least 70,000 in the Washington area, plus future retirees. In fiscal 1983 the system paid $20.3 billion in benefits.

Congressional and administration sources said yesterday that the Civil Service plan, which resembles two previous Reagan proposals is expected to contain these key features for those who were in the system before Jan. 1, 1984:

■ Full cost-of-living increases for retirees would be paid only on the of that amount would also be raised 55 percent of the increase in the cost of living. Retirees now get the full cost-of-living adjustment applied to their full pension. By law, the nation's 1.4 million military retirees must receive the same cost-of-living treatment as civil servants.

■ For future retirees, the initial benefit would be based on average pay for the civil servant's highest five years of earnings, instead of the three highest years. This change would cut pension benefits for many people.

■ In the future, anyone retiring before age 65 would have his pension reduced by 5 percent for every year below 65 that his age is. At present, anyone can retire with full pension at 55 after 30 years of service. This change would be phased in. Those now 55 or over would not be subject to the reduction; those now 50 who retire at 55 would have their pensions cut by one-quarter. Persons who are 45 or under would be subject to the full reduction for each year they retire before age 65.

■ The current employe contribution to the retirement system of 7 percent of pay would be increased over two years to 9 percent.

All these changes would apply to those in the existing Civil Service retirement system, which was closed to new entrants on Jan. 1, 1984. Anyone entering federal employment after that is covered by Social Security and will also receive a supplementary federal pension that Congress must enact this year.

Two plans to shape the new supplementary pension system are under consideration by the Office of Management and Budget and the Office of Personnel Management.

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Restructured Civil Service Retirement Plan Eyed

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involved, one-third less than the old system.

The plan, which sources said is favored by the OPM, would be similar to the old system. The retirement age would be 62 to 65, the same as Social Security. Benefits would be based on years of service and salary. However, the final benefit would be integrated with Social Security benefits, so that the combined final pension would be similar to what a worker in private industry receives from Social Security and a reasonably good private pension.

The other proposal, said to have some support in the OMB, is a "defined contribution" plan. Instead of using a formula based on salary and years of service to compute benefits, the government would put in a certain contribution each year for each employe. When the employe leaves, he receives the total of these contributions plus interest. Employes might be permitted to make contributions of their own to boost their accounts.

Sources also said the OPM is likely to propose restrictions on sick leave and vacation for federal employes.

In another development, OPM Director Donald J. Devine notified all heads of nondefense departments and agencies that "President Reagan has decided to press for further reductions" in the federal work force.

"Additional reductions are to be achieved primarily through attrition," he said and stressed, "There will be no across-the-board freeze in employment in order to force attrition." He added, however, that he doesn't want to see a hiring speed-up in "anticipation" of cuts.

Meanwhile, White House officials acknowledged yesterday that a task force chaired by presidential counselor Edwin Meese III is investigating major cuts in veterans' benefits.

But deputy White House press secretary Marlin Fitzwater said reductions are being considered as part of an across-the-board review and may not be included in the fiscal 1986 budget that Reagan will submit to Congress early next year.

Among the possible reductions being examined is a proposal to exclude veterans from getting free medical care for disabilities not related to their service. Such veterans could receive care, but they might be charged fees based on their ability to pay. This would strip about 90 percent of veterans of the right to free medical care on a bed-available basis at age 65.

Veterans Administration officials said yesterday that they also were ordered to project how much could be saved if the VA treated only the service-connected ailments of veterans and not "systematic ailments" that often develop because of such injuries.

"In other words, you could treat a veteran who had part of his arm amputated, if he complained about a problem with that arm," a VA official said. "But you couldn't treat him for possible circulatory damage that might have been caused by the amputation. This is the narrowest possible definition of VA medical care for veterans."

Other possible changes include giving veterans vouchers for medical treatment and letting them buy medical care with it.

Democratic members of congressional veterans' committees, including Sen. Alan Cranston (D-Calif.) and Rep. G.V. (Sonny) Montgomery (D-Miss.), as well as the American Legion and Paralyzed Veterans of American yesterday sharply criticized the administration for considering these changes.

"It's misguided and wrong," Montgomery said.

Under current law, one of every two American men 65 and older will be eligible for VA medical benefits by 1990. Under current eligibility rules, the VA's $26 billion budget would have to be increased 61 percent to meet demand, a recent VA study indicated.

The White House unsucessfully tried to block release of the VA study before the election. Democratic critics said questions being raised by the White House signal Reagan's intention to deal with the growing rolls by reducing eligibility, instead of increasing spending.

Staff writer Pete Earley contributed to this report.